

SECTION 5

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Probable Developments in China

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SUMMARY

Introductory Note: The purpose of the following discussion is to present probable developments in China which will affect US interests during the next six to twelve months.

1. Communist military forces are capable during the summer months of 1949 of destroying all semblance of unity in the National Government of China; and before the year is out, the Communists will have formed a central government which will seek international recognition.

2. The US cannot reverse or significantly check this course of events, nor is there any prospect that the Soviet orientation of the Chinese Communists can be altered in the immediate future. However, during the coming months, developments in China will raise a number of problems on which the US may either take action advancing, or avoid action compromising, its interests in China and elsewhere. Chief among these are the formation of a Communist central government claiming international recognition, Communist aims regarding Taiwan and Hong Kong, the Communist need for foreign trade, and US aid to anti-Communist groups in China. In addition, US interests probably will be affected adversely by the expansion of Communist influence throughout the Far East, particularly if a Chinese Communist regime gains seats on the Far Eastern Commission and the Allied Council for Japan, and acquires China's claims regarding a future Japanese peace treaty.

3. The government to be organized by the Chinese Communists will be proclaimed as a "coalition," but actually will be a Communist dictatorship. In foreign affairs the Communists during the coming months will continue to be solidly aligned with the USSR. The new regime will honor the Sino-Soviet Treaty of 1945 and its attitude in international relations will be governed by the Moscow line. It will probably maintain an unfriendly attitude toward the US in particular and all other governments that impede the world Communist movement, as well as denounce China's existing international agreements with those governments.

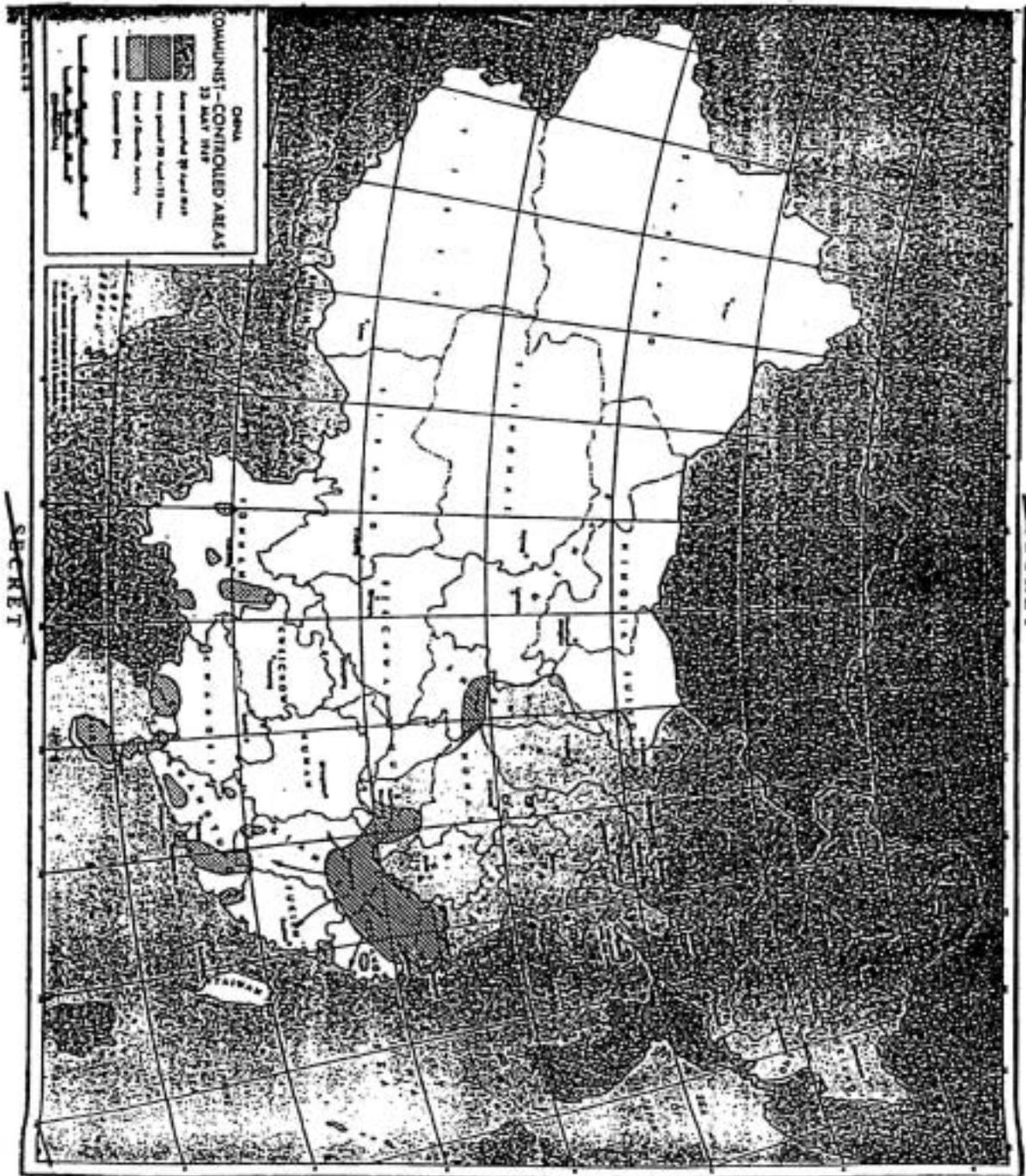
4. Communist armed forces, now decisively superior to the Nationalists, will continue their program of area-by-area acquisition. They are capable of eliminating all effective military resistance in the south, southwest, and northwest by the end of 1950.

5. The Chinese Communists will probably not be faced with serious food shortages during the next year. Some progress will be made in reviving transportation and industry, and the Communists will have a relatively stable currency. The Communists' principal economic problem in the coming months will be that of acquiring petroleum, machinery, and perhaps cotton. There is little prospect of substantial Soviet aid, and domestic resources must be supplemented by these essential imports. Therefore, China's economic recovery during the next year will probably depend on active Western trade and close ties with occupied Japan.

Note: The intelligence organizations of the Departments of Army, Navy, and the Air Force have concurred in this report; for a dissent of the Intelligence Organization of the Department of State, see Enclosure A, p. 21. This report contains information available to CIA as of 2 June 1949.

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PROBABLE DEVELOPMENTS IN CHINA

Introductory Note: The purpose of the following discussion is to present probable developments in China which will affect US interests during the next six to twelve months.

1. *Imminent Problems for the US Arising out of Developments in China.*

The Chinese Communist armies have the capability, during the summer months of 1949, of completing their campaign in the Yangtze Valley, from the eastern border of Szechwan to the sea, and of dislodging the Nationalists from Canton and other ports on the southeast coast during this same period. Their military operations in this period will destroy all semblance of unity in the present National Government, the remnants of which will seek refuge in Taiwan, southwest and northwest China, or in flight abroad. In late summer or early autumn, the Chinese Communist Party will convoke a Political Consultative Conference to form and proclaim a Communist-controlled government for all China before the end of 1949. At that time, Communist China will contain more than half of China's people, and, if not more than half of China's territory, at least the larger part of its most productive areas. The Communist Government then will seek recognition as the national government of China.

The US cannot reverse the course of the Chinese civil conflict nor induce the Chinese Communists to modify their intention to establish a Communist dictatorship over China. Also, there is no prospect that the US can alter the Soviet orientation of the Chinese Communists in the immediate future. During the next few months, however, there will be a number of developments in China affecting US interests such as: (1) possible incidents involving US armed forces, officials, and nationals; (2) sharpening of the Communist-Nationalist struggle for Taiwan, where US strategic interests are involved; (3) Chinese Communist designs on Hong Kong and Macao; (4) US aid to anti-Communist groups in China; (5), the

Communist need for foreign trade; (6) the establishment of a Communist central regime seeking international recognition, and; (7) the expansion of Chinese Communist influence throughout the Far East.

It is known that the leaders of the Chinese Communists desire international recognition for their regime, and that they also desire commercial relations with the West and with Japan. These facts may permit the US, in the course of the next several months, either to take action advancing or to avoid action compromising certain of its interests in China and elsewhere in the Far East.

a. *Possible Incidents.*

In firing upon British warships in the Yangtze, the Communists demonstrated that they are prepared to risk reprisals in order to substantiate their promise to protect China from "imperialist aggression." The Chinese Communist Party (CCP) undoubtedly gained face within China and elsewhere in Asia by this action, and it is possible that the Communists will again take advantage of any opportunities which arise for military action against foreign armed forces. The opportunities for local incidents involving foreign officials and nationals have become much more numerous with the CCP occupation of major cities—as suggested by the forced entry of the US Ambassador's residence by Communist soldiers during their occupation of Nanking. Incidents involving the mistreatment of foreign nationals and the destruction or seizure of foreign property are likely. If the Communist regime should request, and be refused recognition, it is highly probable that such incidents will multiply, with CCP connivance. If the US should extend further support to the Nationalists, such incidents can reach serious proportions.

b. *Taiwan.*

There is no doubt that the CCP desires to extend its control over the island of Taiwan.

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where Chiang Kai-shek is preparing for a last stand, hoping to survive until reinforced by the US at the outbreak of a world conflict which he believes inevitable. The Communist-Nationalist contest for control of the island will become more sharply drawn in the near future, when Chiang Kai-shek and his Nationalist followers will be forced to establish headquarters there.

The CCP is not capable, at the present time, of successfully undertaking an amphibious operation against Taiwan. In the next few months, however, the CCP will not only acquire the mainland coastal ports and shipping to make such an operation possible but also will be able to infiltrate the island, attempt to subvert Nationalist officials there, and exploit the widespread native resentment of Nationalist rule. These developments will improve CCP chances of taking control of Taiwan. The Communist-controlled regime certainly will assert sovereignty over Taiwan, and the leaders of Taiwanese native groups in time may support them in that claim. While civil disorders on Taiwan will probably not be sufficiently serious to wrest the island from Nationalist control, any insurrection which develops on Taiwan is likely to further the purposes of the CCP. There is a prospect of lengthy propaganda warfare, with increasingly successful subversion of Nationalist officials and armed forces, and increasingly damaging civil disorders, which may set the stage for Communist military occupation.

US economic and military aid, short of armed intervention, would probably not significantly assist the Nationalists in holding Taiwan, any more than such aid has helped the Nationalist cause on the mainland of China. Taiwan's economic problem is principally that of Nationalist inefficiency in management, not deficiency in resources; and extensive stocks of military equipment are already stored on the island. Furthermore, such an aid program would make it difficult, if not impossible, to establish normal diplomatic and consular relationships with the Communists, in the event that the US should decide on a policy of recognition of a central government established by the Communists on the mainland.

c. *Western Possessions of Hong Kong and Macao.*

Although Hong Kong, under British control, offers Communist China certain advantages in foreign trade, nationalistic sentiment will almost certainly impel the CCP to press for the return of this colony, as well as Portuguese Macao. The British Government, determined to defend Hong Kong against a possible Communist military assault, is dispatching considerable reinforcements to the colony, thus reducing its capability to meet military commitments in Europe and elsewhere and to maintain a strategic reserve in Great Britain. In addition, the UK is seeking at least moral support from the US for its Hong Kong defense plans. However, Communist military action against Hong Kong and Macao, while possible, is not likely. It is more probable that one of the early acts of the Communist regime will be that of initiating discussions with the British and Portuguese governments in regard to the transfer of authority in Hong Kong and Macao. If the UK and Portugal should withhold *de facto* recognition from the Communist Government, or in some other manner refuse to enter into such negotiations, the CCP will retaliate. The CCP, which presumably does not fear Portugal, may choose to exert military pressure on Macao, as well as to work through the Communist underground. In Hong Kong, rather than taking military action, the CCP will probably choose to operate through the strong Communist underground, which already constitutes a serious threat to the colony and which will become increasingly active. The Communists could cripple Hong Kong by fomenting strikes in transportation and communication facilities, could restrict or cut off food supplies from the Chinese mainland, could sabotage water supplies, could resort to unrestricted piracy against shipping, and could create an exchange rate between the currencies of Hong Kong and Communist China to weaken the economy of Hong Kong. The eventual return of Hong Kong to China, thereby depriving the UK (and indirectly the US) of a valuable but vulnerable Far Eastern naval base, appears probable, but not within the calendar year of 1949.

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d. US Aid to Anti-Communist Groups.

The US is the best available source for the small arms, artillery and ammunition desired by the remaining anti-Communist forces, and it may be anticipated that such forces, individually or in the name of the National Government, will appeal to the US to supply such materiel. However, major anti-Communist forces controlled by Chiang Kai-shek, Chang Chun, and the Moslem leaders of the northwest, Ma Pu-fang and Ma Hung-kuei, even now are located either off the mainland or in the peripheral areas of China. In addition, there is some doubt as to whether any of those forces, except those of the two Mas, could usefully employ further US aid. Chiang's forces on Taiwan already have extensive military and economic resources. Chang Chun's forces in Szechwan do not need economic aid. Moreover, it is improbable that military aid to these forces can prevent the Communists from extending their control over Szechwan at any time they choose to do so.

The Mas of the Northwest (the provinces of Ninghsia, Kansu, and Tsinghai) with the advantages of forbidding terrain, excellent organization, and hardy troops, are in the strongest defensive position of any of the remaining anti-Communist forces in China. Moreover, on the basis of past performance, the Mas, as compared with other anti-Communist groups, would make the most effective use of any aid which they might be given. However, their bases in the provinces of Tsinghai and Ninghsia are the most difficult to reach with US aid, which probably would have to be transported by air. The Northwest area is self-sufficient in food, and may hold out for several years even without US aid, either because the Communists will be reluctant to attack or will favor its development as a buffer against the expansion of the USSR into China through Sinkiang.

Overt US aid to anti-Communist forces in China would compromise the maintenance of normal diplomatic and commercial relations with the Communist-controlled regime, in the event that the US should choose to follow a policy of recognizing such a regime. Furthermore, US military aid to any anti-Communist forces other than the Mas, might well go the

way of the bulk of US aid supplied to the Nationalists in the past—to the Communists. Aid of the type and proportions extended hitherto to the National Government, at best, could delay but will fail to prevent the extension of Communist rule through all China.

A further consideration is the continuation of US aid to Nationalist China, as provided for in the China Aid Program. With Nationalist-held areas soon to be limited to Taiwan and the western provinces of China, it will be difficult to justify the US program on humanitarian grounds as aid to the Chinese people as a whole. Thus the US would become increasingly vulnerable to Communist propaganda, attacking the US aid program as designed solely to bolster and prolong resistance on the part of anti-Communist remnants.

e. Communist Need for Foreign Trade.

Communist import requirements provide the US with a possible weapon against Communist China. Depriving the Communists of essential imports would retard the rehabilitation of China and increase the economic difficulties that will confront the OCP. Some essential imports, chiefly petroleum products and items of capital equipment, can be obtained in quantity only from the US or UK. The USSR, without some sacrifices in its domestic economy, will be unable to supply many kinds of equipment, will provide inferior goods in other cases, and will probably make heavy demands on China in exchange for its assistance.

The controls to be used would probably not be effective if they were so severe as to be in fact an embargo. It is doubtful if the US could arrange for concerted support for an embargo among the Western Powers, and the Communists would gain sympathy and support within China by representing an embargo as "imperialist" persecution. Limited export controls on selected commodities such as petroleum and capital goods probably would be acceptable to the UK, which has the largest economic interests of any Western Power in China, and would probably serve US purposes just as well as a complete embargo.

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On the other hand, there are advantages the US may gain from free trade with Communist China. *Quid pro quo* concessions, such as regularization of the position of US consulates in Communist-held areas of China, might be obtained. The promotion of commerce between Communist China and Japan, furthermore, in addition to being valuable to China, would significantly assist Japan economically and thereby reduce the drain of US support of the Japanese economy.

f. The Communist Desire for International Recognition.

The Communist-controlled regime will seek international recognition as the National Government of China as soon as it is formed and proclaimed—an event which will probably occur near the end of 1949. The attitude of this regime toward the US will be unfriendly, if not frankly and actively hostile. For the purposes of this discussion, it is assumed that the US, when confronted with the Communist regime's request for recognition, will pursue one of three courses: (1) non-recognition, i.e., neither *de facto* nor *de jure* recognition for an indefinite period; or (2) immediate *de jure* recognition, which the Communists presumably desire; or (3) delayed *de jure* recognition, e.g., early *de facto* recognition, but a delay of several months to a year or more in according *de jure* recognition. The consequences of each of these three courses of action are estimated briefly below.

Obviously, the international act of granting or withholding recognition would not effect any genuine change in the ideological hostility of the CCP toward the non-Communist world. So long as the Chinese Communists regard the USSR as the leader of world Communism, and the USSR regards the US as its principal enemy, the conduct of the CCP toward the US will continue to be governed by the international Communist line, as promulgated by the USSR.

(1) *Non-Recognition.*

For the US to refuse recognition to a Communist China would entail a number of unfavorable consequences. There is no prospect that the Nationalists can be restored to authority over any large part of China; the Na-

tionalist leaders, their authority progressively restricted to their place of refuge, are doomed to exile or extinction. In addition, it is improbable that many foreign governments will withhold for a prolonged period recognition of the Communist regime in China; thus, the official representatives and private citizens of governments withholding recognition would find themselves at a disadvantage as compared with the nationals of governments extending recognition. Moreover, the Communist regime, strengthened by recognition by one or more major powers, would claim seats in the UN, other international organizations, and on the Far Eastern Council, and would be supported in its claim by members of such bodies. It is further probable that the Communist regime, if the US were to withhold recognition, would in turn refuse to regularize the position of US consulates in China, and would even force them out of China.

(2) *Immediate De Jure Recognition.*

Immediate *de jure* recognition of the Communist regime, which almost certainly is the CCP's objective, would avoid certain of the adverse consequences of non-recognition. The CCP presumably would be opposed to any international relations short of full *de jure* recognition, because mere *de facto* recognition would permit the Western Powers openly to support anti-Communist elements in China, and because *de facto* recognition has been associated in Chinese eyes with the 1911-27 period of warlordism. Immediate recognition, however, would not alter the basic hostility of the CCP toward the US, and might even encourage the Chinese Communists in their arrogant and intransigent attitude toward the US and toward other powers which followed the US lead, perhaps to the extent that they would follow the Soviet lead in restricting the number and location of US consular offices, particularly in Manchuria. In addition, immediate recognition would probably not cause the Communists to withdraw their threat to repudiate existing Sino-US treaties, or to refrain from obstructing US policies on international issues such as the Japanese peace settlement.

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~~SECRET~~*(3) Delayed Recognition.*

Should the US delay, for a period of several months to a year or more, in according *de jure* recognition to the Communist regime in China, some of the disadvantages of both non-recognition and immediate recognition might be obviated. Since the Communists are interested in obtaining *de jure* recognition as soon as possible, they might be inclined to discuss, and to reach some prior understanding with the US regarding present and future treaties and the number and location of US consular offices in China. This period would also afford other Western governments an opportunity to bring political and economic pressure on the Communist regime. Concerted action by Atlantic Pact powers, which have indicated a desire to maintain a common front, can be anticipated if the delay in according *de jure* recognition is not prolonged to the point where it would become inimicable to their interests. Through the period of a common front, however, there would always be the risk that other governments, seeking special advantage by early action, would proceed unilaterally to extend *de jure* recognition. The Communists can be expected to follow, and probably to improve upon, the traditional Chinese diplomatic practice of playing one power against another.

g. Chinese Communist Influence throughout the Far East.

The CCP has indicated its interest in uniting one billion Orientals in a Communist Asia. To this end, the CCP industriously propagates the view that Communism is inevitable in Asia, and that only the Communists are the champions of Asian "independence." The prestige of Communism will increase enormously as the CCP extends its control over all of China.

(1) Japan and Korea.

The CCP has stated that China and Japan "can and should establish close friendship" and has warned that Japan must conclude a peace treaty with a Communist-controlled government of China. The CCP is attempting to open trade with Japan, and the Japanese Communist Party echoes the CCP line that only "democratic" forces can successfully

conduct commercial and political relations with China. In Korea, the CCP's successes have contributed greatly to the confidence of the North Korean regime and to the feeling of defeatism in the Republic of Korea. Through its relationship with North Korean leaders, the CCP is capable of providing significant military and economic aid to North Korea. The opportunity of South Korean leaders to offset the development of such an adverse trend has largely passed and it now appears that South Korea can do little to forestall such a development. Recognition by the Western Powers of the CCP's regime would be to the advantage of Communist China both politically and economically, insofar as it permitted trade between China and Japan. *De jure* recognition would give the Chinese Communists further opportunity to claim seats on the Far Eastern Commission and on the Allied Council for Japan, as well as weaken further the position of the Korean Republic's government.

(2) Southeast Asia.

The CCP is extending its influence throughout Southeast Asia by identifying itself with native independence movements, by denouncing "reactionary" colonial governments, by threatening "fascist" non-colonial governments, and by promising protection to overseas Chinese communities. *De facto* recognition of the Communist regime by the Western Powers would tend to increase the political and economic influence of the CCP in Southeast Asia. To withhold *de jure* recognition would make the CCP's work in Southeast Asia somewhat more difficult, but the governments and the Chinese overseas communities in that area would pay little heed to such a legalism. The Chinese communities will tend to orient themselves toward the CCP as it acquires control of China although there may be significant resistance elements among the overseas Chinese. Likewise the governments in Southeast Asia will adjust themselves to these new circumstances, whether for accommodation or resistance. The CCP will probably not employ military force to gain its objectives in Southeast Asia and it has no significant economic resources with which to maneuver. Its success in China, however, will

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permit strong and unremitting political pressure on Southeast Asia.

2. Political Situation.

a. Communist China.

(1) Extension of Control.

(a) *Present Extent of Communist China.* Communist China now is divided into six administrative areas: (1) Northeast China, having an Administrative Council but as yet no "People's Government"; (2) Inner Mongolia with an Inner Mongolian Autonomous Government; (3) North China (Hopeh, southeast corner of Chahar, eastern Shansi, western Shantung) having a North China People's Government; (4) Central Plains (Honan, most of Anhwei, northeast corner of Hupeh) with a Central Plains People's Government; (5) East China (Kiangsu and eastern Shantung) with as yet no People's Government; (6) Northwest China (western Shansi, eastern Shensi, eastern Suiyuan, eastern tips of Kansu and Ningxia) with as yet no People's Government. The Communists do not yet have a central government, so that whatever centralized control there is, is exercised by the Central Committee of the Chinese Communist Party, at present located in Peiping.

(b) *Intended Extent of Communist China.* In its New Year's Message for 1949, the CCP stated that its armies would cross the Yangtze in 1949 and that the Party would convoke a Political Consultative Conference to form and proclaim a Communist-controlled government. Without pretending that this government would actually control all China by the end of 1949, the CCP statement strongly implied that the new regime would nonetheless seek recognition as the national government. Subsequent statements have reiterated that it is the CCP's firm intention to extend its control over all China and to destroy all significant political and military opposition. The CCP has announced that, in the interest of preserving the manpower and material resources of the nation, it prefers to negotiate a peaceful transfer of military and political power wherever possible; but that the Communist armies are prepared to effect such transfer of power by military force where Na-

tionalist leaders and forces refuse to cooperate in a peaceful transfer of power.

(c) *Lack of Popular Resistance.* The resumption of the military offensive by the Communist armies has forced the CCP to offer the war-weary people of China some justification for this action. Before and during the April peace negotiations in Peiping, the CCP repeatedly accused the Nationalists of insincerity, at the same time claiming that the people of China did not desire an uneasy truce with the Yangtze as a boundary-line. In their order to continue the drive into South China, Chairman Mao Tse-tung and Commander Chu Teh again accused the Nationalists of negotiating only to gain time for a comeback designed "to destroy the revolution." Although no amount of propaganda can persuade the people of China that the Communists are everything they pretend to be, the bulk of the people in Nationalist China are probably not dismayed by the prospect of a change of government, and may even welcome the prospect of Communist rule, believing that it will bring a greater degree of security and a lesser degree of exploitation.

(2) Transfer of Political Authority.

(a) *A New Central Government.* Because the CCP has not formed or proclaimed a central government asserting authority over all of China, decisions on the question of international recognition of such a government thus far have been postponed. Diplomatic officials in Nanking and consular officials elsewhere in Communist China are regarded by the local Communist authorities as private citizens rather than as the representatives of their governments. This situation is likely to continue until the proclamation of a Communist-controlled government, at which time the question of *de facto* recognition will arise. For the next few months, the CCP will be absorbing large numbers of lower and middle echelon National Government personnel—by far the greater part of these officials stay on the job—thus avoiding a complete break in continuity with the old order. The CCP probably will take the stand that, if foreign powers wish to continue operations in China, either through official representatives or as private

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citizens, they must give at least *de facto* recognition to the regime.

(b) *The "Coalition" Pattern.* The CCP has promised to convoke a Political Consultative Conference in 1949 to form and proclaim a "coalition" government. The Kuomintang as a Party will be excluded from this new "coalition." The CCP has frankly stated that the intended "coalition" government will be "under the firm leadership of the CCP." The concept of "coalition" derives from the larger concept of Chairman Mao's "new democracy," the name given to the transitional stage from today's "capitalist" society to the later "socialist" society. In structure, the "coalition" will include three major blocs: (1) the CCP; (2) non-Communist "democratic parties" which follow the CCP line, such as the Democratic League and the Kuomintang Revolutionary Committee and; (3) "democratic elements," occupational and functional groups which invariably support the CCP's position. While this government will permit some degree of popular participation in the election of representative bodies, all real power will be concentrated in the CCP, whose function it is to "guide" the backward masses.

(c) *Political Consultative Conference.* The Political Consultative Conference will be the medium for creating a new constitutional system and for obtaining some degree of domestic sanction for the new regime, just as the Political Consultative Conference held in 1946 was a symbol of potential National unity. The Chinese Communist Party will convoke this Conference in its own name and in the name of minority parties and functional groups which follow the Communist line, probably in the late summer or early autumn of 1949, after they have consolidated their control of the Yangtze valley. It is not known whether the Conference will consist of a few dozen or several hundred persons; in either case, the Communists will control it firmly. The Conference will either draft and ratify a constitution, or, possibly working through a committee established for that purpose, draft a constitution and set a date for elections to a "constitutional convention." In the latter event, promulgation of the constitution and formal establishment of a constitutional gov-

ernment would be delayed until 1950. In any case, the Conference will simply be a rubber-stamp congress summoned to approve in the name of "the people" policies predetermined by the Communists while its constitution, formally providing for various rights, will, in fact, bestow no rights which the Communists cannot take away.

(d) *Domestic Sanction for the New Order.* In order to gain domestic sanction for the Communist-controlled regime, the CCP, in conjunction with the Political Consultative Conference, will probably exploit the alleged affinities of Communist doctrine and practice with the theories of Sun Yat-sen, generally regarded within China as the "father" of the Republic. The CCP claims that Sun's famous Three People's Principles—"nationalism, democracy, livelihood"—have been more closely followed by the Communists than by the Kuomintang. It points to Sun's advocacy, in the 1920's, of "alliance with the Soviet Union, alliance with the Communists, alliance with the workers and peasants." The CCP may also cite the 1924-27 period, when the Communists were admitted to the Kuomintang by Sun himself, and insist that only the CCP has truly carried out the terms of Sun's will by ushering in the constitutional stage of government which he demanded. The CCP will by no means deify Sun Yat-sen, but his tradition can be very useful in smoothing the Party's path.

(3) *Foreign Relations.*

(a) *Sino-Asian.*

(i) *Japan and Korea.* The CCP, in a broadcast attempting to influence the Japanese elections of January 1949, stated that China and Japan "can and should establish close friendship," and pointed out that Japan must conclude a peace treaty with a Communist-controlled government of China and establish economic and political relations with it. More recently, the CCP has been attempting to open trade with Japan. There is little doubt that China will exert economic pressure and political influence on both Japan and Korea, possibly with a view to subordinating those countries to itself in a Communist Asia. The CCP maintains close relations with Com-

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munist leaders in Japan and Korea, and there is reason to believe that at least some of those leaders are oriented as much toward Communist China as toward the USSR.

(ii) *Southeast Asia.* In recent months, the CCP: (1) has told the Indonesian Republican leaders that they cannot succeed without Communist leadership; (2) has denounced the British and French governments for their activities in China, Malaya, and Indochina; and (3) has threatened retaliation against the "fascist" governments of the Philippines and Siam for "persecuting" overseas Chinese. Assistance to revolutionary movements throughout Southeast Asia, pressure upon the colonial governments concerned, and influence within overseas Chinese communities will certainly increase as the CCP extends its control throughout China and obtains international recognition of its "coalition" government. However, the extension of CCP influence in southeast Asia will not be unopposed, because of the deep-seated fear of "Chinese imperialism" in these countries.

(b) *Sino-Soviet.* Chinese Communist relations with the USSR should continue to be extremely cordial. In major policy statements of the past year, the CCP has endorsed the Cominform's denunciation of Tito, called upon "revolutionary forces" throughout the world to unite under Soviet leadership against "American imperialism" and promised that China will be the ally of the USSR in any West-provoked war. The CCP's tactical procedures have found orthodox justification in Lenin's and Stalin's expositions of the principles governing "colonial" revolutions, and the CCP is now bringing its policies more nearly into accord with those of more "advanced" revolutions. There are points of potential conflict between the USSR and the CCP—such as possible Soviet inability to assist in China's industrialization, Soviet designs in China's border regions, the CCP's intentions toward Communist movements in Asia, and the general issue of subservience to Moscow—but none of these issues seems likely to cause serious friction in the near future. The "coalition" government will certainly give the USSR preferential status in China, perhaps by expanding the Sino-Soviet Treaty of

1945—which the CCP has repeatedly endorsed—to provide for a high degree of military and economic integration between the USSR and China's border regions. For the present, CCP leadership appears genuinely to feel that China's best interests will be served by close Sino-Soviet cooperation.

(c) *Sino-US.*

(i) *"Traitorous" Treaties.* The CCP position, in regard to treaties concluded by the National Government since early 1946, has been that such treaties were concluded without the knowledge and consent of the parties—among them the CCP—participating in the Political Consultative Conference of 1946, and that the CCP therefore does not recognize their validity and "absolutely will not bear any obligation" for them. The CCP has stated that "all those (treaties and agreements) detrimental to the Chinese people and nation, especially those which sell out national rights, should be abrogated, revised or reconcluded, according to the circumstances." The Sino-Soviet Treaty of 1945 has been specifically excluded by the CCP from those treaties which "sell out national rights." The Sino-US treaties which the CCP regards as "traitorous" are those which provide for economic and military aid to the National Government and the stationing of US armed forces in China. The CCP view appears to be that, first, the post-1946 Sino-American treaties are "traitorous" simply because they were concluded with the US, the principal enemy of world Communism, and, second, that US economic and military aid to the National Government was employed principally in the struggle against the Communists. In addition, the CCP has indicated its intention of repudiating the existing Sino-US "Treaty of Friendship, Commerce and Navigation" (1948), on the grounds that this agreement is an instrument of US "imperialism" in China. In order to develop trade with the US, however, the CCP may come to see the desirability of negotiating a new agreement of this nature.

(ii) *The US as an Enemy.* As the CCP has proclaimed the USSR as China's principal friend, the US has been portrayed with equal

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feror as China's outstanding enemy. The CCP has represented the US as the leader and supporter of all "imperialist" and "reactionary" forces in the world, as forcing "traitorous" treaties upon China in exchange for financing the Nationalists in the civil conflict, as directing the military operations of the Nationalists and encouraging them to reject the Communist-dictated "peace agreement," and as plotting with forces inside and outside China to destroy the CCP and keep the Orient in permanent slavery.

While the CCP has understandable grounds for resenting the US contribution to the Nationalists' military operations, the CCP's present anti-Americanism is primarily dictated by the opposite CCP and US positions regarding the USSR and world Communism. US official representatives and private citizens in Communist China, although not subjected to physical violence, have been restricted in their movements and in the discharge of their consular, commercial, or educational functions, while the CCP is exploiting the US loss of prestige in China and enhancing its own prestige by an intransigent attitude toward the Western Powers. The "coalition" government will presumably invite US recognition and attempt to conclude commercial treaties with the US but the CCP can be expected to give aggressive support to Soviet and satellite diplomacy, to continue its vigorous and irresponsible anti-American propaganda, to bring pressure upon the US to withdraw its assistance to Nationalist remnants on Taiwan and to make the work of US diplomatic missions difficult. At present, there is little chance of orienting the CCP away from the USSR.

(d) *Other Foreign Relations.* The CCP has adopted an attitude toward foreign governments hostile in proportion to the degree that those governments are impeding the world Communist movement, regardless of whether such governments have or have not supported the Nationalists in the Chinese civil conflict. The fact that the UK has been of service to the CCP, in affording sanctuary and an operating base to CCP leaders in Hong Kong, did not restrain Communist forces from

firing upon British warships in the Yangtze. Neither will it prevent the CCP from demanding the return of Hong Kong to China nor will it obviate the possibility of giving support to terrorist bands operating against the British in Malaya.

The CCP undoubtedly intends to deprive Portugal of the colony of Macao, by negotiations, if possible, but by military action if necessary. The French Government has been denounced by the CCP for encouraging US "imperialism" in China and for its actions in Indochina. The Netherlands Government has been similarly castigated by the CCP in regard to Indonesia. All other Atlantic Pact states have been the targets of CCP propaganda abuse, both for joining the Pact and for other "reactionary" activities. India, which is probably recognized by the CCP as its principal rival for leadership in Asia, is characterized as remaining under the influence of British "imperialism."

Representatives of the Commonwealth countries and of a number of European governments in China have expressed a desire to become accredited to the Communist regime soon after it is proclaimed. These representatives would like to regularize their status by early recognition of the Communists in order to protect and perhaps expand their present interests in China. They have not regarded the prospect of applying economic sanctions to China with favor and they apparently anticipate profitable commercial relations with the new regime in varying degrees. At the same time, the governments of most Commonwealth and Atlantic Pact nations have admitted the desirability of maintaining a united front on the question of recognition.

b. *Nationalist China.*

Nationalist China is virtually bankrupt and the National Government is in its death throes. The process of disintegration and fragmentation is so far advanced as to render almost impossible the establishment of a functioning government or even a loosely organized coalition capable of offering resistance to the Communists.

The National Government no longer functions as an organized administration even on

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a regional basis. Since Chiang Kai-shek's retirement from the presidency in January, there has been little evidence of leadership or central direction of the Government. (Acting President Li Trung-jen has little power and his effectiveness has been little greater than that of a well-meaning warlord.) The Executive Yuan has accomplished little for months; even the basic ministries are limping along ineffectually. The Legislative, Control and Judicial Yuan in Canton are rump organs with slight influence. Political power is largely in the hands of provincial or regional bodies. Taxation and other basic governmental functions are localized.

The Nationalist split into factions headed by Chiang and Li has hastened the process of disintegration and fragmentation. Although Chiang retired as President without resigning, he has continued to control armies, military and financial resources, the secret police, the party agencies, and many leading officials. Acting President Li nominally heads the Government, but, in his weakness and frustration, has done little else than conduct the abortive peace negotiations which ended on 20 April. The struggle between Li and Chiang is so intense that any significant rapprochement or compromise appears improbable. Li controls Kwangsi and has the support of Pai Chung-hsi, various southern warlords, and many peace-seeking officials. He will probably continue his nominal leadership of the Canton Government until Communist military pressure compels Nationalist leaders to seek refuge elsewhere, at which time Li will probably try to maintain a government in Southwest China.

Chiang Kai-shek controls Taiwan and adjacent areas on the southeast coast, and has a diminishing influence in the southwestern provinces. Chiang has been transferring Nationalist resources systematically to Taiwan, which is being prepared as the final refuge to which many Nationalist officials in Canton will flee when the city is threatened by the Communists. Large numbers of refugees from mainland China are already in Taiwan and the provincial administration is headed by Chiang's appointee, General Chen Cheng. Although Nationalist rule is increasingly unpopular with the oppressed, unorganized na-

tive population, the Nationalists probably will be able to maintain a regional regime in Taiwan for at least the remainder of the year 1949. The major threat to their position will come from mainland Communist forces rather than from the local people.

As in the recent past, the National Government's foreign relations during coming months will be dominated by issues concerning the US and the USSR. Nationalist China has depended greatly on US economic and military aid, which still continues in diminishing quantities, although no future US military commitments are in prospect. Despite repeated failures to obtain additional aid, the National Government and Nationalist regional regime will continue their appeals to the US and claim that such aid will be used to resist the Communists.

In Taiwan, the Nationalists have an important bargaining point. Aware of US interest in that island, they will present themselves as a means and perhaps the sole means of preventing its communization, and will offer various inducements and assurances in return for US aid and US moral support for a regional Chinese regime. They will also argue the legality of such a Chinese administration despite the fact that Taiwan's status has not been formalized by conclusion of a peace treaty with Japan.

The National Government will strive to keep its international status despite its growing weakness. Depending chiefly on what future Communist policies may be, that status might not be seriously challenged for several months and foreign recognition of the National Government will probably continue so long as it stays in Canton.

Chiang Kai-shek and other Nationalist leaders are embittered toward the USSR, which they feel is at least partly responsible for their misfortunes. The idea of appealing to the UN has been seriously considered in Nationalist circles and the matter may be brought up again before the Nationalists lose their international status. If made, this maneuver would be accompanied by denunciation of the Sino-Soviet Treaty of 1945, governing the status of Manchuria and Outer Mongolia.

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While such antagonistic measures might be directed against the USSR on the one hand, the National Government might at the same time effect an apparent rapprochement with the Soviet Union and conclude agreements involving further concessions, particularly in Sinkiang and the Northwest provinces.

In its last stages of existence, Nationalist China may turn its wrath against the US. In Nationalist thinking, the US is largely responsible for the Yalta agreement, and the US postwar policy of mediation in the civil war and intermittent limited assistance have facilitated the Communist triumph. Such feelings will be intensified if the US rejects further appeals for aid and evidences interest in recognizing a future Communist-dominated Chinese Government.

3. Military Situation.

a. General Strategy.

The objective of the Chinese Communist forces is the elimination of all anti-Communist armed resistance in China. To attain this objective the Chinese Communist Party has employed the strategy of using military force as a medium of realizing their political objectives. Communist control over the remainder of China will be accomplished by means of an area-by-area program of military acquisition, dictated to a large degree by the state of their political preparedness for administering these areas.

The remaining Nationalist or anti-Communist forces have now adopted the strategy of avoiding decisive military action, while at the same time attempting to deny territory to the Chinese Communists as long as possible.

b. Communist Armed Forces.

The Chinese Communist Forces possess sufficient wealth in material and manpower to overcome all anti-Communist remnants in China. Having already eliminated the majority of the best Nationalist armies, the CCP is now in the process of consolidating its recent virtually unopposed military conquest of the Yangtze valley. In consequence, Communist armies, free to accelerate their movements to the south and the west, appear to be headed toward Kwangtung. As elsewhere, however, the speed and magnitude of this operation

probably will be limited in some degree by the abilities of the CCP political organization to assume the additional administrative responsibilities.

Recent CCF victories have brought with them the new responsibility of protecting communications, urban life, and industry. Consequently a considerable portion of CCF must be utilized to garrison "liberated" areas and maintain lines of communication.

(1) Strength and Disposition of Communist Ground Forces.

The Communist regular forces comprised of the field forces and Military District troops now total approximately 2,017,000 (see Table, p. 14), thus giving the CCF a decisive numerical superiority over the Nationalists in combat strength. These regular forces, particularly the field forces, are characterized by good leadership, good equipment, high morale and discipline, as well as excellence in intelligence and the employment of propaganda. In addition to the regulars, there are irregular forces, known as the People's Militia, generally local in character and function, totalling perhaps 2,000,000. Such forces, on occasion in the past, have supplemented the regulars during a campaign. In the future, they will probably be occupied largely with the task of policing CCP areas. A third potential source of manpower comes from Nationalist troops which have fallen into Communist hands. Of these, approximately 90,000 have been integrated into the CCF. Communist regulars will also be greatly assisted in their drive south by dissidents, bandits, and irregular Communist bands, already in control of wide rural stretches in the southern provinces.

(2) Air Force.

The Chinese Communist Air Force made its first public appearance during 1949 May Day celebrations in the Mukden area. Both B-25 and F-51 type aircraft participated in the air parade. The Communists are known to have obtained by defection or capture at least 38 operational aircraft including bombers, fighters, transports, and trainers. The actual number of pilot defections is believed to be substantially greater than the 20 known cases although the Communist claim of 2,000 is con-

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ORGANIZATION OF CHINESE COMMUNIST FORCES, 25 MAY 1949

REGULAR FORCES

New Unit Designation	Old Unit Designation	Commander	Strength	Areas
1st Field Army	Northwest People's Liberation Army	Peng Teh-huai	158,000	Shensi-Shansi
2nd Field Army	Central Plains People's Liberation Army	Liu Po-cheng	321,000	Yangtze and South China
3rd Field Army	East China People's Liberation Army	Chen Yi	400,000	Yangtze
4th Field Army	Northeast People's Liberation Army	Lin Piao	720,000	Yangtze and North China
5th Field Army	North China People's Liberation Army	Nieh Jung-chen	383,000	North China
Undesignated Regulars in South China			35,000	South China
Regular Forces Total			2,017,000	
IRREGULAR FORCES: The People's Militia			2,000,000	

CAPTURED NATIONALIST TROOPS: Only the approximately 90,000 troops in the units enumerated above have been included in CCF strength. Remainder are not yet believed to have been integrated into the CCF order of battle.

Note: The total regulars includes an estimated 636,600 Military District Troops and former Nationalist troops of the ex-Nationalist 38th, 59th, 60th and 77th Armies, and 84th and 110th Divisions, with an aggregate total of approximately 90,000 troops.

sidered to be greatly exaggerated. There is no evidence that Soviet aircraft observed in CCP areas of Manchuria have been there in any but a transient capacity. No Communist aircraft have been used in the combat areas and lack of aviation fuel will drastically limit the CCP capability for air operations.

(3) *Navy.*

The CCP has acquired by defection and capture upwards of 63 Nationalist naval vessels. The following is a breakdown, as to types, that may be operational in Communist hands as of 31 May 1949:

- 3 Destroyer escorts (DE)
- 1 Mine-sweeper (AM)
- 7 Gunboats (PG)
- 1 Repair Ship, light (ARL)
- 1 Icebreaker (AGB)
- 1 Landing Ship, medium (LSM)
- 1 Landing Craft, Infantry (LCI)
- 17 Landing barges
- 17 Armed motorboats
- 14 Small patrol boats

For the most part, crews of the foregoing craft and those of other naval craft which have been disabled or destroyed are available to the Com-

munist. These craft, plus merchant shipping which may be captured or otherwise acquired, will provide the Communists with a growing capability for short over-water operations.

(4) *Logistics.*

The CCF, hitherto almost solely dependent on animal transport, makeshift machine-shop arsenals, and captured Nationalist stores for logistic support, has now overcome this earlier handicap. In addition to substantial Japanese stockpiles turned over to them in Manchuria during 1945-46, the CCF, having captured tremendous Nationalist stocks which were largely US-supplied—now enjoys superiority in materiel over the Nationalists. In addition, the CCF has acquired most of the industrial centers of North and Central China—including the Mukden arsenal, which alone produced some 60-70 percent of the total Nationalist ordnance output. This and other installations taken over by the CCF can supply all the materiel needed for future mainland operations. In place of horse-cart methods of supply, the Communists now control and are rapidly rehabilitating most of China's rail and

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water transport net. A north-south rail line from Manchuria to the Yangtze has already been opened.

c. Anti-Communist Armed Forces.

The Chinese Nationalist armed forces, although defeated by the Communists and lacking cohesive command structure at present, were not beaten by the sheer force of arms. Very few major battles, such as those witnessed in World War II, were fought. From the resumption of Nationalist-Communist hostilities in May 1946 until September 1948, the Chinese Communists employed guerrilla tactics of hit, ruin and run, with resultant minor but effective actions. In September 1948, the Chinese Communists stormed Nationalist Tsinan, where, much to the Communists' surprise, key Nationalist defections brought about by the disintegration of local troop morale led to the collapse of government resistance. The debacle at Tsinan established the pattern for subsequent defections; from September 1948 to May 1949, a rising wave of mass defections, sell-outs, and general unwillingness to fight swept through the Nationalist armed forces. The defeat of the Chinese Nationalist Army, therefore, can be attributed basically to internal decay. Although the strategic error of over-extension of forces contributed in part, the basic reasons for Nationalist defeat were, and continue to be: (1) army politics, which kept militarily incompetent officers in positions of high command; (2) the personal command of all combat areas exercised by Chiang Kai-shek, which prevented independent tactical action by field commanders; (3) accelerating economic decay, which resulted in inadequate pay, food, clothing, and equipment for the troops; and (4) graft and corruption, practiced by senior officers at the expense of their troops.

In consequence of these conditions, Nationalist morale disintegrated from top to bottom and Nationalist forces lost the all-important "will to fight." Nationalist armed forces, today, have ceased to be an organized, cohesive and centrally directed military machine. They now exist as a group of widely scattered, disorganized, and uncoordinated regional anti-Communist "warlord" forces.

(1) Strength and Disposition of Nationalist Ground Forces.

The strength of the remaining anti-Communist armies in China totals approximately 720,000 regular combat troops. In addition, there are some 500,000 service troops dispersed throughout the remaining areas of Nationalist operation (see Table, p. 16).

The "combat" forces listed in the accompanying table include a high percentage of poorly trained and ill-equipped provincial levies. Not included are an undetermined number of local (Peace Preservation Corps) troops.

At present, there are basically four separate centers of potential anti-Communist resistance in China. These are: (1) the southeast (including Taiwan) directly under Chiang Kai-shek—approximate strength, 300,000; (2) the southern provinces of Kwangtung and Kwangsi, under Li Tsung-jen and Pai Chung-hsi—approximate strength, 200,000 plus; (3) the southwest, under Chang Chun (possibly including the troops of Hu Tsung-nan)—approximate strength 225,000; and (4) the northwest, under Ma Pu-fang and Ma Hung-kwei—approximate strength, 100,000.

(2) Air Force.

The Nationalist Air Force has from 85,000-100,000 men and approximately 1000 aircraft, of which 600 are reportedly operational. The potential of the CAF has also been reduced by losses through defection and capture. Five-sixths of the CAF's total of 1,000 aircraft have been transferred to Taiwan. Because of maintenance difficulties and operational accidents only 35 percent of the operational aircraft are effective. The morale of the air forces, although somewhat higher than the ground forces due to differences in pay scales, is still very low. Consequently, CCP propaganda has found and continues to find a receptive audience in the ranks of the air force.

(3) Navy.

The Nationalist Navy, lately weakened by the loss of upwards of 63 craft (of which at least a light cruiser, destroyer escort, and a gunboat have been destroyed or disabled) has approximately 150 ships, not including harbor craft, and about 30,000 men. Navy morale, as

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ORGANIZATION OF ANTI-COMMUNIST FORCES, 15 MAY 1949

Commander	Strength	Loyalty	Present Area	Future (?)
Tang En-po	250,000 *	Chiang Kai-shek	Unknown *	Fukien, Taiwan
Pal Chung-hsi	150,000	Li Tsung-jen	Hunan, Kwangsi	Kwangsi
Hu Tsung-nan	175,000	Chiang Kai-shek	South Shensi	Szechwan
Ma Pu-fang	120,000	Self	Northwest	Northwest
Ma Hung-Kwei				
Chang Chun	40,000	Chiang Kai-shek	Taiwan	Taiwan
Hsueh Yuch	50,000	Undetermined	Kwantung	Kwantung
Chen Cheng	30,000 **	Chiang Kai-shek	Taiwan	Taiwan
Liu An-chi	30,000	Chiang Kai-shek	Tsingtao	Taiwan (?)
Total Combat Forces	845,000			
Service and Miscellaneous Troops	500,000			
Total	1,345,000			

Note: * Subject to revision when Nationalist withdrawal from Shanghai is clarified—last estimate of strength in Shanghai was 100,000. The other troops under Tang (150,000) are withdrawing southward from Nanking-Shanghai area.

** Number could be augmented by Nationalist withdrawals from the mainland.

in the other services, is extremely low and Communist infiltration of the navy continues.

(4) Logistics.

The Nationalist field forces have been depleted in numbers and deprived of the larger part of their weapons, transportation, and equipment. Their central supply organization is now defunct and, more important, their central supply base, from which unit materiel replacements had previously been obtained, is now non-existent. The Nationalist field commanders find themselves facing logistics similar to those encountered by Communist field commanders a year ago. The Nationalists must now depend largely upon their own private resources and ingenuity for logistic support. The anti-Communist forces, largely confined to marginal regions, will hold only two areas which can presently contribute substantial logistic support. These are Szechwan, with some 13 major arsenals as well as rich agricultural resources, and Taiwan. Taiwan, which produces an agricultural surplus, has lately received US military aid shipments as well as arsenal installations transferred from the lower Yangtze Valley.

The northwest, in contrast, requires air supply, and the entire sweep of southern China is incapable of supporting large armies and broad-scale military operations over an

extended period. Long-term resistance in these areas, therefore, would require a steady flow of supplies, both military and economic, from outside China. Communication in the south and southwest can be kept open only so long as the loyalty of the people in those areas is retained.

d. Present and Future Operations.

The objective of the latest Chinese Communist offensive, begun on 20 April, is to secure the lower Yangtze Valley from Szechwan to the sea and at the same time drive a wedge deep into south China in order to separate the forces of Pal Chung-hsi and Li Tsung-jen in Kwangsi from those of Chiang Kai-shek in the southeast. The southern drive on Canton and Foochow, additionally, will accelerate fragmentation of the Nationalist Government by forcing further flight to Taiwan or Chungking or possibly to both.

The primary Communist objective probably will be realized by the end of August. At no time from now on can the Nationalists be expected to put up more than token resistance, since their first concern will be withdrawal of their remaining troops intact to Taiwan and the more remote areas of the southwest. By the end of 1949, in consequence, the Chinese Communists probably will exercise military control over all of mainland China from Man-

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churia south to Kwangtung and from the eastern border of Szechwan to the sea.

(1) *Communist Military Problems.*

Although the Communist forces have all the advantages at present, when they move to eliminate the last areas of resistance they will face certain entirely new problems. The Communist armies will be moving into extremely rough mountainous terrain in their drive to the southwest and the northwest. In order to support their occupation armies adequately, they must of necessity greatly extend their lines of supply and communication into these food-deficit areas. Although Communist forces will be greatly assisted by dissidents, bandits, and irregular CCP bands in the south and southwest provinces, they will, particularly in the northwest, be moving into a great expanse of territory where the local populace is either actively or potentially hostile. The expanding Communist armies will also face the problem of how to feed, clothe, indoctrinate, and otherwise dispose of captured or defected anti-Communist forces.

The acquisition of Taiwan is another problem for the CCP: The Communist armies have no amphibious experience or training. At present, they lack the requisite shipping to undertake an assault on Taiwan. The lack of amphibious experience, moreover, may force the CCP to be satisfied with the much slower political methods of underground action to accomplish their conquest of the island.

Perhaps the largest problem facing the CCP lies in preventing the military machine from outrunning their abilities for political consolidation. To halt their victorious armies would not only belie CCP propaganda but would probably shake troop morale from top to bottom. Over-all success, therefore, depends upon the maintenance of a very delicate balance between CCP military acquisitions and political preparedness.

(2) *Nationalist Problems.*

Problems currently facing the remaining Nationalist Armed Forces appear to be insurmountable. The present centrifugal tendency in Nationalist China is a recreation of conditions once almost nation-wide, which the surviving warlords understand well, but which

makes central planning and control virtually impossible. The remaining Nationalist troops are desperately in need of re-equipping, re-training, re-vitalizing, and re-organizing under a competent and effective central command. It appears unlikely that these basic Nationalist needs will be fulfilled. Consequently, anti-Communist forces in China when threatened by the Communist armies, must further withdraw, capitulate, or be annihilated.

(3) *Estimate of Capabilities.*

(a) *Nationalist.* Remaining Nationalists or anti-Communist forces cannot, in the foreseeable future, effectively resist the Communist military machine. Even if it were possible to cure existing military ills by means of outside assistance, superficial reforms would be ineffectual unless the ailment is also treated—the troops must be re-instilled with the will to fight. This can only be accomplished by paying the troops in accordance with the cost of living, by feeding and clothing them properly and, above all, by giving them something to fight for. This obviously is impossible under present conditions. The CCP, therefore, can and probably will eradicate any and all regional anti-Communist armed resistance whenever it chooses to do so.

(b) *Communist.* The CCP is currently capable of launching simultaneous operations to the south, southwest, and northwest and eliminating all effective military resistance by the end of 1950. However, in view of Communist logistic and morale problems which undoubtedly would result from too fast a take-over, the CCP will probably continue its methodical area-by-area conquest and it may be 2 to 3 years before the final liquidation of all anti-Communist resistance in China. The south and southwest will probably be the first two entries on the CCP military time-table and the coup *de grace* reserved for the Mas in the Northwest.

4. *Economic Situation.*

a. *Nationalist China.*

The economic activities of the National Government in Canton and of each provincial government (except Taiwan and Szechwan) are largely confined to the search for sufficient

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revenue to maintain their military and political power. Economic and commercial paralysis throughout most of non-Communist China has pauperized both the National and most provincial governments.

The financial position of the National Government at Canton is desperate. It has suffered from a serious decrease in revenue because of its inability to collect taxes, the widespread repudiation of the national currency, and the virtual elimination of customs duties. In addition, State-owned industries and enterprises have largely ceased to operate and the profits of many remaining plants are no longer available to any but local political administrations. Reserves of gold and silver still under Canton's control are very limited and most provincial governments are reported to be in a similarly serious fiscal situation.

While most of non-Communist China is impoverished, Szechwan and Taiwan are exceptions. Both areas possess a relatively sound economy. Other important Nationalist assets are a considerable amount of coastal and ocean shipping and the gold bullion in Taiwan.

b. Communist China.

(1) Internal Problems.

(a) Economic Objectives. The first economic objectives of the Communists will be: (1) the acquisition of all assets owned by the National Government and "bureaucratic capitalists"; (2) the preservation of governmental financial and commercial institutions; and (3) obtaining the support of productive elements of society. The Nationalist assets least accessible to the Communists are the three million-odd ounces of gold controlled by Chiang Kai-shek, the overseas assets and holdings of the Government and its "war criminal" officials, private holdings and the million tons of shipping now in Nationalist hands. It is unlikely that an appreciable amount of industrial plant will be removed to Nationalist areas, and the Communists should inherit Nationalist industries largely intact.

(b) Food Problems. While the possibility exists that the Communists may not be able to overcome the war's disruption of marketing facilities in a short time and that Manchurian surpluses may be pre-empted by the USSR,

no starvation is expected in Communist areas before the June harvests, except in some flooded or war-desolated localities.

Although the coastal cities long have imported rice, grains and vegetable oils, because of the high costs of transport from inland areas of production to coastal consumption centers, there is probably enough food in the Yangtze Valley to supply these cities, if the CCP can solve the problems of collection and distribution.

(c) Development of Transportation and Industry. That some progress in industrial reconstruction has begun is indicated by reports from Manchuria, Tsinan, Peiping, Tientsin, and many towns in North China which show that the reopening of industries and railroad reconstruction in liberated towns is a high-priority task. Shortages of raw material, power, and skilled labor will continue to limit Communist development of industry after control over Central China is consolidated but, with the exception of petroleum and possibly cotton which must be imported, there will be sufficient resources to run most existing industry at a high level of capacity.

The need for petroleum in Central China will decrease as coal becomes available in larger quantities and as such large oil consumers as power companies are reconverted to coal. Domestic collection of cotton for textiles, China's chief industry, will be large and, together with present stocks in Shanghai, should be nearly adequate for this year's needs. Rehabilitated railroads, together with captured junks and barges on the Yangtze River and its tributaries, should provide adequate internal transportation for essential marketing purposes.

(d) Gaining Support of Productive Elements. The CCP will try to gain the active support of productive elements in the middle classes who may not yet be entirely convinced of the bountiful life which is promised under the Communist order. The Communists have declared that taxes must not be confiscatory, that governmental enterprises harmful to private enterprises shall not be permitted, that workers must not demand excessively high wages, and generally that all means will be utilized to encourage private industrial pro-

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duction. While these promises have largely remained unfulfilled, they have gained wide support for the CCP among Shanghai and Nanking businessmen. Among the middle classes, those most actively wooed by the Communists are the technicians. They are offered high pay (in Mukden reportedly twice that of government officials) and the chance to be leaders in China's reconstruction. The CCP has apparently gained the support of responsible technical and managerial groups in other Communist areas in China and may do so in Central China as well.

Urban workers and the farmers may not be as strenuously recruited, both because their support is already assumed and because increased rewards to the middle classes must frequently be made at the expense of the lower income groups. While continued lip service will be paid to better living standards, workers will be told that, as the "leading" political group, they must carry the burden of economic reconstruction and development. Similarly, few promises, other than reduced rents and interest rates, may be made to the tenant farmers, since landlords have already been promised that the country is too "backward economically" for immediate drastic land redistribution.

(e) *Financial and Commercial Problems.* The CCP has shown considerable concern over the establishment of internal financial stability and the resumption of domestic commerce. The lack of financial experts will seriously hinder the Communists in the establishment of a stable and flexible currency which will be adequate for the commercial and industrial needs of North and Central China. Conditioned by the recent Nationalist experience with paper currency, the Communists in the immediate present may continue to rely on a less flexible exchange system based on barter and tax payments in grain and other commodities. To date, the Communists have been sufficiently successful in collecting agricultural output, which has provided them with a substantial source of revenue.

Although transportation and marketing difficulties will hinder domestic trade, both state and, to a lesser degree, private commerce

has been encouraged by the CCP's commercial policy and probably will continue to be. "Liberation" of the Yangtze Valley will probably yield to the Communists the huge collection-and-sale apparatus of the Central Trust and other National Government agencies, thus reinforcing and firmly establishing the Communist state trading base.

Further, CCP acquisition of the Yangtze region will be an important factor in curing the present paralysis of internal commerce by restoring the normal integration of the Central and North China economies.

(2) *External Problems.*

(a) *Requirements in Foreign Trade.* Petroleum, cotton, and the railroad, factory, and power equipment needed for reconstruction are the principal imports that the Communists will require during the next year. Inadequate amounts of any of these items will seriously hamper economic recovery. Fuel-oil requirements can be met in part by the substitution of coal, which should be available in quantity to the Communists. But kerosene, gasoline, lubricants and other petroleum products which have no substitutes must be imported. Current Chinese consumption, including aviation gasoline, is 15-20 million barrels annually and 10-12 million barrels would probably be a minimum continuing annual requirement, with full utilization of coal and with no increase in the level of economic activity.

Reconstruction requirements for China are enormous. A minimum reconstruction program, calling for rebuilding China's prewar industry and railroads and perhaps one-half of Manchuria's peak industrial capacity, would require imports of US \$300-\$500 million in China and a similar amount in Manchuria. The bulk of the expense would be for railroad equipment; the remainder would largely be textile, mining, and power machinery and equipment. Reconstruction offers special difficulties to the Communists since substantial credits or investments from the USSR are unlikely and there are severe political obstacles in the way of Western investments. In the next few years, the Chinese Communists will be confronted with the problem of paying for

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their rehabilitation through their own efforts.

(b) *Trade with the USSR.* Soviet domination of Manchuria will be a major factor in directing the course of China's foreign trade in the next year. The Soviet Union will continue to take most of Manchuria's grain and soybean crops to meet the deficits of edible oils throughout the USSR and of food in the Soviet Far East. The total value of these imports from Manchuria may well be in excess of US \$100 million annually, at world market prices. In China Proper, the USSR does not have the same dominant position with respect to foreign trade that it enjoys in Manchuria. The foreign trade of China Proper is more likely to be directed to the non-Soviet countries because of the limited market in the USSR for such important Chinese exports as bristles, processed eggs, handicrafts, and coal.

The disadvantages to China of the Manchurian trade with the USSR derive largely from the cheap monopoly price that the Soviets have been able to obtain on soybeans, the chief Manchurian export. Through its control of the Manchurian railroads and the port of Dalren, the USSR has been able to prevent the export of Manchurian products to world markets. Necessarily, trade with the Soviet Union on such unfavorable terms tends to impair China's ability to finance her essential import requirements. In China Proper, the Communists will be freer to maximize their return by directing their exports to whatever country offers the highest prices. Exports to non-Soviet countries will provide the Chinese directly with the means needed to obtain essential imports, such as petroleum, railroad equipment, electrical and other industrial machinery, and chemicals—products which can be obtained from these countries more readily than from the USSR.

(c) *Trade with the US.* The advantage of CCP trade with the West and with Japan lies in the character of China's import requirements and her export markets. These advantages particularly apply to US trade, which, in the postwar period, has been the largest of any country's with China.

The US would be a major source for petroleum, certain types of capital equipment, and vehicles. If the US alone were excluded from trade, Japan, the UK, and other Western countries might fill a portion of China's reconstruction needs but it is unlikely that these countries can make sufficient capital goods exports in the next year to satisfy all of China's requirements.

Not only will China probably be forced to depend on the US for essential imports, but the market for many Chinese commodities, such as handicrafts, tung oil, and animal products is determined by US demand. Were the US market eliminated, China's exports would be reduced substantially, her export industries depressed, and her ability to pay for needed imports greatly restricted. China's chances for economic recovery in such circumstances would be small.

(d) *Trade with Japan.* Smaller transportation costs would permit Japan to outbid the world market for many of China's exports. In the case of China's export of such bulk commodities as coal, iron ore, and salt, Japan would be the only commercially important feasible market. In return, Japan could sell to China machinery and railroad equipment which significantly would aid the CCP rehabilitation program. Trade, profitable to both countries, could in a few years total US \$3-400,000,000 annually, an amount which would be a substantial portion of China's total foreign trade.

Although Chinese antipathy toward the industrial revival of Japan is a political factor militating against such large-scale trade, it is very likely that the urgent economic considerations of recovery will override such an objection. Indeed, the CCP's Ministry of Industry and Commerce in Tientsin suggested resumption of Japan trade in April and Premier Yoshida has repeatedly declared that Japan "will and must" trade with China. Japan's market, as well as that of the US, is very important in the long run for the achievement of Chinese economic independence and recovery.

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ENCLOSURE A

DISSENT OF THE INTELLIGENCE ORGANIZATION, DEPARTMENT OF STATE

The Intelligence organization of the Department of State dissents from the subject report on the grounds that it does not give adequate treatment to the implications of the anticipated desire of a Communist China for international recognition. The treatment here-

in accorded this highly complex and technical subject makes for an over-simplification which is considered unsatisfactory in view of the important policy decisions inevitably involved in the present Chinese situation.

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